FILE COPY

FILED
NOV 2 1933
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933

No. 65

LILY CLAPIER,

Petitioner,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.,

Respondents.

BRIEF OF RESPONDENTS REORGANIZATION COMMITTEE.

LAWRENCE BENNETT,
MAYNARD TEALL,
G. FRANKLIN LUDINGTON,
Counsel for Respondents Reorganization Committee.

INDEX

	PAGE
OPINIONS OF THE COURTS BELOW	1
JURISDICTION	2
COUNTER-STATEMENT OF THE CASE	2
CONCLUSION	3

STATUTE

U. S. Judicial Code, Section 240a	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 65

LILY CLAPIER,

Petitioner,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.,

Respondents.

BRIEF OF RESPONDENTS REORGANIZATION COMMITTEE IN REPLY TO BRIEF OF PETITIONER LILY CLAPIER.

Opinions of the Courts Below

The opinion of the United States Circuit Court of Appeals for the Third Circuit is reported in 64 Federal Reporter (2d Series) at page 847, *et seq.*, and appears in the printed Transcript of Record at pages 59-69, inclusive. The opinion of the District Court is not reported but appears in the printed Transcript of Record at pages 51-53.

Jurisdiction

The jurisdiction of this Court rests on § 240a of the Judicial Code as amended by Act of February 13, 1925, c. 229, § 1, 43 Stat. 938 (28 U. S. C. A., § 347a).

Counter-Statement of the Case

This case had its inception December 11, 1931, with the filing in the District Court of the United States for the Western District of Pennsylvania of the petitioner's dependent bill (R. 2), contesting the appointment of Receivers in the cause then pending in that Court entitled "Rudolph B. Flershem, Charles O. Cornell, John H. Waters, *et al.*, as the Reorganization Committee, etc., Complainants, *v.* National Radiator Corporation, Defendant, No. 2558 in Equity", sometimes called the "primary cause". The primary cause itself is before this Court for review at Nos. 62, 63 and 64. The petitioner's dependent bill was in the nature of a demurrer to the creditors' bill filed by the Respondents in the primary cause (R. 6), the defendant Corporation's answer thereto (R. 44), and the order entered thereon October 9, 1931, appointing Receivers (R. 46). To this dependent bill the Respondents (as complainants in the primary cause) filed a motion to dismiss (R. 50), on the ground that said bill was wholly without equity and failed to state facts sufficient to constitute a cause of action. The District Court, concurrently with the decree of sale entered May 31, 1932 in the primary cause, dismissed the petitioner's bill (R. 53), stating (R. 52, 53):

> "The bill is couched in the most general terms and, which charging improper collusion between the

defendants, sets out nothing in a specific way from which any fraud upon complainant is to be inferred.

"Incidently, we may say that we have heard like charges in the original case (No. 2558 In Equity), but the evidence did not tend to sustain them. * * *

"We are entirely satisfied that the original case was within the jurisdiction of the court, and that the appointment of receivers therein was justified."

Counsel for the petitioner thereafter appeared at the hearing on confirmation of sale held August 18, 1932, to object on behalf of other petitioners against confirmation of the sale and the District Court's approval of the Reorganization Plan sponsored by the Respondents. In consequence, as the petitioner's brief (page 12) states, this is a "companion case of *Artz and Ramsey, Petitioners,* v. *Rudolph B. Flershem, et al.,* No. 64 now also before this Court". The grounds upon which the exercise of jurisdiction by the District Court was sustained are in consequence discussed by counsel for the petitioners in their brief in the case of *Artz and Ramsey, Petitioners,* v. *Rudolph B. Flershem, et al.,* No. 64 upon the calendar of this Court. Since in our own answering brief we deal with the merits of the primary cause, to save repetition, we rest upon the arguments submitted by us in our other briefs, to which we respectfully refer this Court.

Conclusion

Upon the ground that all proceedings in the primary cause have been properly taken by the District Court and have in all respects been affirmed by decree of the Circuit Court of Appeals, we respectfully submit that the decree

of the Circuit Court of Appeals affirming the decree of the District Court dismissing the petitioner's ancillary bill be affirmed.

Respectfully submitted,

LAWRENCE BENNETT,
MAYNARD TEALL,
G. FRANKLIN LUDINGTON,
Counsel for Respondents Rudolph B. Flershem, Charles O. Cornell, John H. Waters and Frank B. Cahn, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation.

SUPREME COURT OF THE UNITED STATES.

Nos. 62, 63, 64 and 65.—October Term, 1933.

First National Bank of Cincinnati, et al., Petitioners,		
62	*vs.*	
Rudolph B. Flershem, et al.		
First National Bank of Cincinnati, et al., Petitioners,		On Certiorari to the United States Circuit Court of Appeals for the Third Circuit.
63	*vs.*	
Rudolph B. Flershem, et al.		
Amy Arzt, et al., Petitioner,		
64	*vs.*	
Rudolph B. Flershem, et al.		
Lily Clapier, Petitioner,		
65	*vs.*	
Rudolph B. Flershem, et al.		

[January 8, 1934.]

Mr. Justice Brandeis delivered the opinion of the Court.

These cases, which are here on certiorari to the Circuit Court of Appeals for the Third Circuit, (289 U. S. 722), were argued together. They arise out of the Plan of Reorganization of the National Radiator Corporation of Delaware dated February 11, 1931. The Reorganization Committee sought to effectuate its Plan through securing, in a suit filed in the western district of Pennsylvania, the appointment of receivers and a judicial sale of the property. In that suit the federal jurisdiction was invoked on the ground of diversity of citizenship; the original plaintiffs being citizens of states other than Delaware and one of them a citizen of the district in which the suit was brought. The Corporation, a citizen of Delaware, was the sole defendant. The District Court appointed receivers, and entered decrees ordering the sale, confirming it, approving the Plan, and directing the receivers to convey and deliver to the purchaser the entire property. The Circuit Court of Appeals affirmed the decrees. 64 F. (2d) 847. The

petitioners in No. 64 urge that the final decrees should be reversed as to them on the ground that the court lacked equity jurisdiction or that the bill lacked equity. The petitioners in numbers 62 and 63 urge that the decrees should be reversed as to them mainly because the property was sold at a grossly inadequate price. The petitioner in No. 65 is the plaintiff in a bill of review, brought in the same court, praying that the order appointing receivers be vacated. Its dismissal, which was affirmed on appeal, is alleged to have been erroneous.

In August, 1927, National Radiator Corporation was organized to effect a merger of six independent manufacturers of radiators and boilers for heating purposes. The net assets of the consolidated corporation, which included ten manufacturing plants located in five states and warehouses in four others, were valued at $26,192,-261.72. The capital was represented by 270,000 shares of no-par common stock; 60,000 shares of $7 cumulative convertible no-par preferred stock; and $12,000,000 twenty-year 6½ per cent sinking fund gold debentures. These had been underwritten, and were marketed, by J. & W. Seligman & Co. and Bankers Trust Company of New York. The terms governing the issue of the debentures and the rights and remedies of the holders thereof were fixed by an indenture between the Corporation and the Bankers Trust Company, as trustee.

In January 1931, the management of the Corporation concluded, after months of consideration and conference with the bankers, that a revision of its capital structure was desirable in order to effect a drastic reduction of the debenture liability and the elimination of all fixed charges; and that, to this end, default should be made in the payment of the February 1, 1931 interest on the debentures. Before the merger, the constituent concerns had operated successfully for many years. After the merger the business ceased to prosper. By the end of 1931, all but three of the ten manufacturing plants had been closed; the outlook for the immediate future was obscure; and there was no definite promise of an early recovery in earning power.[1]

A meeting of the Board of Directors was called for the purpose of taking formal action in respect to the payment of the February

[1]The Corporation acquired by the merger ten plants. Two at Johnstown, Pa.; two at New Castle, Pa.; one at Framingham, Mass.; one at Trenton,

1, 1931 interest. Although the Corporation had suffered (including depreciation and sinking fund charges) large losses in each of the years 1928, 1929 and 1930, its financial condition was still excellent. On December 31, 1930, the ratio of current assets to all current liabilities was more than 10 to 1; the current assets, including raw material and stock in process and manufactured, being $5,054,007.30. The ratio of cash on hand to all current liabilities was then 3½ to 1. It had $1,701,899.94 cash and $1,132,563.17 in good accounts receivable; whereas its debts presently payable were only $46,787.60 (besides $293,339.58 for semi-annual interest accrued on the debentures but not payable until February 1, 1931, $151,768.54 of accrued taxes and like items, and $60,000 in notes payable in one, two and three years). The twenty-year debentures outstanding had been reduced from $12,000,000 to $10,716,000.[2]

After presenting to the Board the December 31, 1930, financial statement, the Chairman said:

"That although the working capital of the Company as shown by the balance sheet was reasonably ample, it was evident that, if the Company were to do an increasing volume of business, it would require the use of all or a substantial part of this cash to carry larger inventories and receivables, and that it would also be necessary to make large expenditures for the design of new products and for equipment necessary in their manufacture. Otherwise, the Chairman pointed out it might well prove to be impossible to maintain the Company's competitive business as against other enterprises in the industry. The Chairman then referred to the fact that the management had considered the advisability of a reorganization and had requested Messrs. Rudolph B. Flershem [the Chairman of its Executive Committee], Charles O. Cornell [a member of a firm specializing in reorganizations] and John H. Waters [the corporation's President] to act as a Committee to consider the matter and to formulate a Plan of Reorganization which might be submitted to the security holders of the Company. The Chairman reported that this Committee was

N. J.; one at Chicago, Ill.; and one each at Utica, Dunkirk and North Tonawanda, N. Y. One plant had been sold in 1927 and one was shut down. Two were closed early in 1929. In 1930 one plant was shut down because of the decline in business, and one in 1931 before the receivers were appointed.

[2]On December 30, 1931, at which time Banker's Trust Company, trustee for the debenture holders, recovered judgment for the entire principal outstanding, the amount had been further reduced to $10,673,000.

now considering the matter of reorganization and had formed the opinion that a reorganization was advisable."

The recommendations of the management were adopted by the Board of Directors. It was voted to default in the payment of the February 1 interest; the holders of the debentures were notified that the default was deemed advisable in order to conserve the Corporation's cash resources; and, under date of February 11, 1931, an elaborate "Plan and Agreement of Reorganization" was submitted to the security holders for acceptance.

The Plan did not provide for raising additional capital. It was directed solely to reducing the liability on the debentures and eliminating all fixed charges. It provided that a new corporation be organized which would take over all the assets of the existing one, continue the business, and pay in cash all the current debts for merchandise and services; that the debenture indebtedness be scaled by giving for each $1,000 of the 6½% twenty-year sinking fund debentures, $500 of the new corporation's 5% fifteen-year income debentures (without sinking fund provision),[3] 5 shares of its $7 preferred stock (entitled to $100 a share on involuntary liquidation and $115 a share on voluntary liquidation) and 20 shares of its common stock. Holders of the preferred stock in the existing company were to receive therefor, share for share, common stock in the new; and holders of the common stock of the existing company might (upon payment of $1), receive for every three shares a stock warrant, entitling the holder to purchase on or before July 1, 1941, one share of common stock in the new company upon payment of $20 per share. The Plan made no provision for dissenting debenture holders.

The Reorganization Committee proceeded to solicit deposits of securities under the Plan. Before September 15, 1931, it had secured the deposit of about 81 per cent of the debentures and a large part of the preferred and common stocks. On that day it declared the Plan operative. On the same day it made a settlement with an opposing bondholders' protective committee,[4] whereby

[3]Moreover, the existing debentures were entitled to be secured by a prior lien against any subsequent mortgage; the new debentures were entitled only to an equal lien with any subsequent mortgage. The Committee later agreed with an opposition committee (see note 4) that the lien should be prior.

[4]The opposition committee were to receive $35,000 for fees and expenses of the members and counsel; and one of its members, to be designated by the Reorganization Committee, was to become a member of the latter and of the board of directors of the new company.

it secured additional deposits of about 9 per cent of the debentures. Later, other deposits were received; so that ultimately more than 95 per cent of all outstanding debentures were deposited under the Plan.

Some holders of non-assenting debentures demanded payment of their overdue coupons, including those for the August 1, 1931 interest. When payment was refused, the holders of $24,000 of the debentures brought an action therefor; and counsel gave notice of intention to bring a further action on coupons attached to others. In order to frustrate these attempts to collect the interest, and in order to compel the minority debenture holders to acquiesce in the Plan of Reorganization, the Committee commenced, on October 5, 1931, this suit praying for the appointment of receivers with power to continue the business; for a sale of the properties as an entirety; and that meanwhile all creditors be enjoined from enforcing their claims. The bill set forth the existing capital structure, the defaults in the payment of interest, and the Plan of Reorganization. It did not allege that the corporation was unable to pay the interest; or that it was insolvent; or that its assets while ample were not then available for payment of its debts. The bill alleged merely that:

"The defendant has no means at hand with which to meet, pay or satisfy the interest charges on the Debentures overdue as aforesaid without seriously jeopardizing the ability of the defendant to continue its business and without making it difficult or impossible for the defendant to secure the necessary supplies, materials and labor to continue the operation of its plants and the sale of its products."

"[That] certain holders of the debentures not deposited with the complainants have threatened to bring suits in respect of interest due on their coupons and may levy execution upon the property of the defendant." . . . "[That] unless the Court will take jurisdiction in this cause for the protection of every interest in the property and assets of the defendant, the result will be a multiplicity of suits, a race of diligence, wasteful strife and controversy;" and dismemberment of the properties [and that] "It is to the best interests of the defendant and the complainants and other creditors of the defendant that the going concern value of the defendant's business and properties should be maintained", etc.

On October 9, 1931, the Corporation entered its appearance; filed an answer admitting the truth of the allegations contained in the bill; joined in the prayers thereof; and consented to the

appointment of receivers. On the same day receivers were appointed with power to continue the business; and creditors were restrained from enforcing their claims against the property. One of the receivers was Robert S. Waters, a Vice-President and General Manager of the Corporation and the son of John H. Waters, its President, Chairman of its Board of Directors and member of the Reorganization Committee. The other receiver was William G. Heiner, a Pittsburg lawyer. With like consent, ancillary receivers were appointed in ten other jurisdictions in which the Corporation had property; and also in Delaware where it had none.

When the bill was filed, and when the receivers were appointed, the Corporation could have paid from the cash on hand all overdue debenture interest, as well as all its other current liabilities, without impairing its ability to continue the business. The cash on hand was $1,257,381.59.[5] The overdue interest amounted then to $709,3[illegible]9.[6] That $547,985.90, the difference between these two amounts, was more than the amount required for working capital is demonstrated by action of the receivers. Two weeks after their appointment, they applied for and obtained from the court leave to invest "such amount or amounts of cash of the receivership estate as in the judgment of the receivers is not needed at the time for expenses and working capital." Thereupon, they invested $1,030,000 of the cash in United States treasury certificates of indebtedness and in bank certificates of deposit.

The Bankers Trust Company, as trustee for the debenture holders, cooperated in all respects with the Reorganization Committee; served as depositary under the Plan; made formal demand for payment of the overdue interest; and brought, with leave of court, suit for the amount of the overdue interest on all outstanding debentures and recovered judgment therefor; thereupon declared the principal of the debentures immediately payable; recovered judgment therefor on December 30, 1931; and then intervened in the receivership suit as plaintiff.

---

[5]On the day of their appointment, the receivers had also $1,494,327.22 in sound receivables and at least $34,534.40 in securities convertible in cash.

[6]The aggregate of other current liabilities (including amounts not then payable) was only $157,511.89. There was besides the August 1, 1931 requirement for the sinking fund. But the debentures held by the Corporation applicable for this purpose reduced the requirement of cash to $43,918.50.

In due course, application was made for an order of sale. The District Court did not make an appraisal by independent experts. In fixing the upset price and in confirming the sale, it relied practically upon the evidence given, or introduced, by officers of the Corporation and the members of the Reorganization Committee. On May 31, 1932, the decree ordering a sale was entered; the upset price was fixed at $2,500,000; and a date after the sale was set for a hearing on its confirmation and on the fairness of the Plan. An appeal from this decree was taken forthwith. At the sale, held August 8, 1932, the property was purchased in behalf of the Committee for $2,550,000 cash. The purchasers assigned their rights to the new company, National Radiator Corporation of Maryland, which agreed to enter an appearance in this cause; and upon the petition of the purchasers and the new company, a decree was entered finding the Plan fair; confirming the sale; and directing that the property be transferred to the new Corporation free and clear of all obligations to creditors of the old. Thereupon, the assets were conveyed to the new company, over the objection of some of the petitioners that the appeal already filed rendered the court powerless to take or approve further action. The same counsel acted for the Reorganization Committee, the receivers and the new company.

While all the petitioners refused assent to the Plan and all appealed to the Circuit Court of Appeals from action of the District Court, the differences in their several positions and contentions are such as to require separate consideration of their legal rights.

First. Amy Arzt and Josephine Ramsey, the petitioners in No. 64, hold $121,000 of the debentures. They appeared specially at the hearing on the confirmation of the sale; objected, among other things, on the ground that the court lacked equity jurisdiction of the subject matter; appealed to the Circuit Court of Appeals from the decree affirming the sale; and contended there and here that, since they refused assent to the Plan, the decree should, as to them, be declared void, and reversed. Whether strictly there was lack of equity jurisdiction, we need not decide. Compare *Burnrite Coal Co.* v. *Riggs,* 274 U. S. 208; *Lion Building and Surety Co.* v. *Karatz,* 262 U. S. 640; *Pusey & Jones Co.* v. *Hanssen,* 261 U. S. 491. For the suit is clearly without equity. The court's power was invoked for a purpose for which it may not be exercised.

We have no occasion to consider under what circumstances a court of equity may, through appointment of receivers and judicial sale, lend aid to protect the interests of creditors and effect a reorganization of an insolvent corporation.[7] Nor need we consider under what circumstances a court of equity may, because the assets of a corporation are ample to meet all liabilities but cannot then be immediately converted into cash, properly appoint receivers in order to preserve values and prevent unequal treatment of creditors.[8] The case before us is of a different character. The possibility of insolvency was not mentioned when the board of directors voted to make default in the payment of the semi-annual interest on its funded indebtedness and approved the Plan of Reorganization. While defaulting on its debentures, the Corporation continued its business operations and paid promptly its merchandise and other unfunded indebtedness. Insolvency was not present, or imminent.

---

[7] All the cases in which this Court appears to have exercised this power in aid of reorganization upon the ground of insolvency dealt with railroads or other public utilities where continued operation of the property and preservation of its unity seemed to be required in the public interest. Milwaukee & Minnesota R. Co. *v.* Soutter, 2 Wall. 510; Davis *v.* Gray, 16 Wall. 203; Union Trust Co. *v.* Illinois Midland Ry., 117 U. S. 434; Wallace *v.* Loomis, 97 U. S. 146; Wood *v.* Guarantee Trust Co., 128 U. S. 416; Quincy, Missouri & Pacific R. R. Co. *v.* Humphreys, 145 U. S. 82; Louisville Trust Co. *v.* Louisville R. Co., 174 U. S. 674; Re Metropolitan Receivership, 208 U. S. 90; Kansas City R. Co. *v.* Central Union Trust Co., 271 U. S. 445; compare Sage *v.* Central R. R. Co., 99 U. S. 334; Shaw *v.* R. R. Co., 100 U. S. 605. Moreover, in all those cases the sale was made upon foreclosure. In Brown *v.* Lake Superior Iron Co., 134 U. S. 530, and Leadville Coal Co. *v.* McCreery, 141 U. S. 475, where the defendant corporation had allowed the receivership of a rolling mill to proceed nine months without answering and creditors did not object until after the decree of sale, this Court refused to decide whether originally the suit should have been allowed to proceed.

The Act of March 3, 1933, c. 204, Sec. 77, 47 Stat. 474, amending the Bankruptcy Act, provides: "Reorganization of railroads engaged in interstate commerce. (a) Any railroad corporation may file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization."

[8] In National Surety Co. *v.* Coriell, 289 U. S. 426, 435, the question before this Court was not the equity of the bill, but the propriety of the procedure pursued by the District Court when approving the plan of reorganization. Compare Michigan *v.* Michigan Trust Co., 286 U. S. 334, 343; Shapiro *v.* Wilgus, 287 U. S. 348, 356. Filene *v.* Weed, 245 U. S. 597; Riehle *v.* Margolies, 279 U. S. 218; Munroe *v.* Raphael, 288 U. S. 485.

The debentures were not to mature until 1947. Insolvency even in the remote future was not certain. This company defaulted when it was both solvent and liquid. It defaulted, although it had cash in bank equal to three and a half times its total current liabilities, including this interest. It defaulted, although the amount of the cash on hand was so large that, even if the interest had been paid, the surplus of cash remaining would have been more than was then required for working capital.

This deliberate disregard by the Corporation of the legal rights of the debenture holders is sought to be justified on the ground that the management, looking to the long future, concluded that the course taken would enure to the benefit of the business and all concerned—would benefit bondholders as well as stockholders. The default was the first step in a proposed revision of the capital structure by which the funded indebtedness would be cut in half and all fixed charges eliminated. The management, whose competency had been challenged, functioned as members of the Reorganization Committee. Having failed to obtain the assent of all the security holders to its Plan, the Committee sought the aid of a court of equity to compel the minority's acquiescence; and the Corporation joined as defendant in the prayers of the bill. Reorganization was the primary relief sought. The appointment of the receivers and the judicial sale were the device employed to effect a transfer of the assets of the existing corporation to a new one, thereby relieving both from the payment of the former's debts.[9] By these means it was hoped to subject all dissenting creditors to the condition of impotency so frequently occupied by minority stockholders.

The substantive law affords no warrant for so abridging the rights of individual creditors. There is no contention that the

[9]Unless all debenture holders assented to the Plan, it could not be effectuated except through the medium of a judicial sale. For the indenture with the Bankers Trust Company, trustee, provided that the property of the Radiator Corporation should not be sold as an entirety unless "as a part of the purchase price for the sale of the property of the company as an entirety [the purchaser] expressly assumes in writing the due and punctual payment of the principal and interest of all the debentures;" whereas the main purpose of the Plan was to cut in half the amount of the debenture liability and to eliminate all fixed charges through transferring the entire property to a new company.